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RUEHLO/AMEMBASSY LONDON 0568
RUEHML/AMEMBASSY MANILA 3180
RUEHNE/AMEMBASSY NEW DELHI 5036
RUEHBUL/AMEMBASSY KABUL 0435
RUEHLH/AMCONSUL LAHORE 7382
RUEHKP/AMCONSUL KARACHI 1780
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SIPDIS
SENSITIVE BUT UNCLASSIFIED

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SUBJECT: Iran-Pakistan Pipeline Moves Closer to Reality as the Two Countries Sign a Gas Purchase Agreement

¶1. (SBU) Summary: Iran and Pakistan intend to sign a Gas Sales Purchase Agreement in Istanbul on June 5, bringing the long-debated pipeline a step closer to reality. Although India has apparently dropped out of the equation, Pakistan and Iran have agreed to a 25-year proposal for the supply of at least 750 million cubic feet of gas daily via a pipeline to be built through Baluchistan. Although the GOP estimated capital costs of the pipeline to be $1.2 billion, they are likely to be much higher, once security is factored in. In the optimistic scenario presented by the GOP, financial close will be reached by March 2010, and construction will be completed by 2013. End Summary.

¶2. (SBU) On June 4, Advisor to Prime Minister on Petroleum and Natural Resources Dr. Asim Hussain announced that Pakistan and Iran would sign a Gas Sales Purchase Agreement (GSPA) for the Iran-Pakistan (IP) gas pipeline project in Istanbul on June 5. India, an original party to the pipeline, is not included in the project at this time. Pakistan and Iran decided to sign a GSPA in a third country after disagreements on legal jurisdiction; the agreement will be governed by French law. The 25-year agreement contains a five-year renewal option. The Pakistani team is led by the Managing Director of Inter State Gas Services (ISGS), Hassan Nawab, and a representative from the National Iranian Oil Company will sign for Iran.

¶3. (SBU) The capital costs of the Pakistani portion of the pipeline are estimated at about $1.25 billion, to be funded with a debt-equity ratio of 70:30. Given the strategic nature of the project, the GOP will hold the majority of the shares in the pipeline corporation. Debt financing is proposed to be secured from a combination of domestic and international financiers and the target date for achieving financial close is March 2010.

¶4. (SBU) Sui Southern Gas Company (SSGC) and Sui Northern Gas Pipeline Limited (SNGPL), government owned enterprises, will construct the pipeline under the supervision of a German project management consultant, ILF. The consultant will also prepare a bankable feasibility study, secure project financing, and provide procurement support. The actual construction of the pipeline is planned to begin in 2010 and to be complete in 2013.

¶5. (SBU) Iran has agreed to reduce the diameter of the pipeline

from 56 to 42 inches due to the absence of India. Dr Asim maintained that India would have to lay an additional 42-inch pipeline if it rejoined the project at a later date. Pakistan has agreed to import a minimum of 750 million cubic feet per day (mmcfd), which is nearly 25 percent of the country's current gas production and which will be able to generate approximately 4000MW of electricity.

¶6. (SBU) The gas is to be supplied from Iran's South Pars gas field and delivered at Pakistan-Iranian border, near Gwadar. The Pakistan section of the pipeline is to be laid close to the Mekran Coastal Highway from the border to Nawabshah, a distance of over 785 kilometers.

¶7. (SBU) The gas price will be $7 per million British thermal unit (mmbtu) if calculated at $50 per barrel crude oil, $9.40 per mmbtu, and $13 per mmbtu, calculated at $70 and $100 per barrel, respectively. Sources at the Ministry of Petroleum confirmed that the pricing formula is based on 80 percent price of Japan crude oil, although no mention was made of this benchmark at the press briefing.

¶8. (SBU) Dr. Asim also maintained that Iran has promised to export 1000 MW of electricity to Pakistan, another outcome of President Zardari's recent visit to Iran. (Note: Iran has been exporting a small amount of electricity to the Gwadar area for many years. End Note)

¶9. (SBU) Comment: This pipeline project has been under discussion for almost 15 years, initially including India as an end user. The

sticking point has always been Iran's high price demands, as well as the difficulties involved in any negotiation between India and Pakistan. With India out of the picture, at least temporarily, it appears that Pakistan has succumbed to its urgent need for energy and agreed to pay Iran's high asking price. Pakistan maintains that generating electricity from imported gas is cheaper than any other liquid fuel option, and Pakistan currently generates over 60 percent of its electricity from furnace oil, a high-cost, high-polluting option. Reliability of supply remains questionable, not only because of the uncertain track record of Iran, but also due to security considerations along the proposed route of the pipeline in Baluchistan, where separatist violence is common.

¶10. Comment (Cont'd.) The GOP is well aware of U.S. objections to the pipeline under ISA, but in past responses to our demarches has requested our understanding of Pakistan's difficult position, due to the energy crisis it is confronting.